

**UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MONTANA**

In re

BRENDON KEITH RETZ,

Debtor.

Case No. **04-60302-7**

BRENDON KEITH RETZ, et al., Trustee,

Plaintiffs

-VS-

DONALD G. ABBEY,

Defendant,

Adv No. **04-00049**

**DONALD G. ABBEY, Individually and for
TIMBERLAND CONSTRUCTION, LLC,
TIMBERLAND PROPERTIES, LLC,
COPPERWOOD PROPERTIES LLC,
CREEKWOOD LOTS LLC,
EDGEWOOD PROPERTIES LLC,
RIVERSIDE PROPERTIES LLC,
ABBHEY/LAND, LLC, and LAKESHORE
DRIVE PROPERTIES, LLC,**

Third Party Plaintiffs,

-VS-

**BRENDON KEITH RETZ and
TIMBERLAND CONSTRUCTION, INC.,
MISTY REED RETZ, RYAN JAMES RETZ,
THOMAS T. TORNOW, WHITEFISH
CREDIT UNION, JAMES H. COSSITT, and
JOHN DOES 2-5,**

Third Party Defendants.

MEMORANDUM OF DECISION

At Butte in said District this 22nd day of March, 2005.

Pending in this adversary proceeding, which was removed from state court on April 22, 2004, by the Chapter 7 Trustee of the above-captioned case Richard J. Samson, is the Motion to Dismiss Claim for Attorneys' Fees for Failure to State a Claim Upon Which Relief Can Be Granted, filed on January 25, 2005, by Third-Party Defendant James H. Cossitt ("Cossitt") ("Cossitt's Motion"), and objections thereto filed by Third-Party Plaintiffs Donald G. Abbey, Timberland Construction, L.L.C., Timberland Properties, L.L.C., Copperwood Properties, L.L.C., Creekwood Lots, L.L.C., Edgewood Properties, L.L.C., Riverside Properties, L.L.C., Abbey-Land, L.L.C., and Lakeshore Drive Properties, L.L.C. (collectively referred to hereinafter as "Third-Party Plaintiffs"), and by Cross-Defendant Whitefish Credit Union. Hearing on Cossitt's Motion was held after notice at Missoula on March 14, 2005. Cossitt was represented at the hearing by attorney Keith Strong ("Strong"). The Third-Party Plaintiffs were represented by attorneys Michael G. Black ("Black") and Edward A. Murphy ("Murphy"). Whitefish Credit Union, which joined and adopted the Third-Party Plaintiffs' objection, was represented by attorney Ronald A. Bender ("Bender"). No testimony or exhibits were admitted. The Court heard statements from the parties' counsel, after which it took the matter under advisement.

The instant proceedings are related to the above-captioned Chapter 7 bankruptcy case under 28 U.S.C. § 1334(b), and involves a multitude of claims, some of which are core and others non-core.

Cossitt's reply filed February 18, 2005, admitted that his Motion to Dismiss does not

reach the Third-Party Plaintiffs' claims for disgorgement of the fees which Cossitt has already collected or for disallowance of Cossitt's pending fee requests, but instead seeks dismissal only of the Third-Parties' claims for attorneys' fees incurred in prosecution of their legal malpractice action against Cossitt. That claim is set forth in the Third-Party Plaintiffs' Third Amended answer, affirmative defenses, counterclaim and Third-Party Complaint filed December 1, 2004, (Docket No. 147¹), beginning at Part IV on page 19, incorporating preceding factual allegations and adding allegations that Cossitt breached his fiduciary responsibilities as receiver/custodian of certain of the Third-Party Plaintiffs under Montana law. Paragraph 9 on page 21 of Docket No. 147 alleges Cossitt failed to exercise due and reasonable care required of attorney for certain of the Third-Party entities and seeks treble damages under Mont. Code Ann. § 37-61-407. The prayer for relief, Part V, of Docket No. 147 prays for, *inter alia*, for "an award of interest, actual costs, actual expenses and actual attorneys' fees as allowed by law or the parties' contracts" at paragraph 16, page 28.

Cossitt filed an answer on December 20, 2004 (Docket No. 162), admitting and denying the material allegations of the Third-Parties' claims against him and asking that the Third-Party Complaint be dismissed. In paragraph (b) of his prayer for relief, Cossitt prays that he be awarded his reasonable attorneys' fees and costs².

DISCUSSION

¹Whitefish Credit Union filed a complaint against Cossitt (Docket No. 148), seeking damages and attorneys' fees for Cossitt's alleged breach of fiduciary duties, but Cossitt's Motion does not address Whitefish Credit Union's complaint.

²Cossitt's prayer for attorneys' fees and costs reflects the same defects which he alleges justifies dismissal of the Third-Party Plaintiffs' prayer for attorneys' fees and costs – Cossitt cites no statute or contract provision authorizing and award of attorneys' fees.

A. Contentions of the Parties.

Cossitt moves to dismiss Third-Party Plaintiffs' claim for actual attorney fees based on Fed. R. Civ. P. 12(b)(6) (applicable under F.R.B.P. 7012(b)) and the "American Rule". Cossitt argues that Third-Party Plaintiffs have not alleged any contractual or statutory basis for recovering their fees, that Montana follows the American Rule and no equitable exception applies, and that common law exceptions from other jurisdictions do not apply in Montana. Cossitt contends that none of the Montana statutes cited by Third-Party Plaintiffs apply in the instant case to support their claim for attorneys' fees³.

The Third-Party Plaintiffs and Whitefish Credit Union object to Cossitt's Motion to dismiss their claim for attorneys' fees and costs, contending that attorneys' fees are recoverable from an attorney who acts in a fiduciary capacity and commits errors and delays, lost evidence, and improperly commenced litigation, as consequential damages or in mitigation of loss, and based on principles of equity. Third-Party Plaintiffs argue that Cossitt failed his burden for dismissal under Rule 12(b)(6) for failure to state a claim. They contend that Cossitt was no longer necessary as a receiver after the bankruptcy filing, that a contractual provision in a promissory note allowed Lakeshore Drive Properties, L.L.C., attorneys' fees, and that Cossitt failed to protect security thereby exposing Timberland Construction, L.L.C., Donald G. Abbey, and other Third-Party Plaintiffs to litigation and consequential damages including attorneys' fees which are recoverable against Cossitt. They seek attorneys' fees under equitable principles from Cossitt for his commencing judicial proceedings when Cossitt lacked standing and had no court-

³Cossitt's reply (Docket No 181) addresses Mont. Code Ann. §§ 35-8-803; 35-8-902; 37-61-402; 37-61-407, 37-61-421; and 71-3-124.

ordered authority to prosecute such actions.

B. Rule 12(b)(6) – Failure to State a Claim Upon Which Relief Can Be Granted.

Cossitt's Motion is based on Rule 12(b)(6), seeking dismissal of Third-Party Plaintiffs' claim for attorneys fees under the American Rule. The standard under Rule 12(b)(6) is strict.

The Ninth Circuit explained in *Wright* that a complaint should not be dismissed for failure to state a claim "unless it appears beyond a doubt that plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Wright v. Riveland*, 219 F.3d 905, 912 (9th Cir. 2000). In considering whether to dismiss Third Party Plaintiffs' claim for attorneys' fees the Court must take all allegations of material fact in the Third-Party Complaint as true and construe them in the light most favorable to the Plaintiff. *In re Daou Systems, Inc. Sec. Litig.*, 397 F.3d 704, 709-10 (9th Cir. 2005); *Gompper v. VISX, Inc.*, 298 F.3d 893, 895 (9th Cir. 2002). It is improper for the Court to dismiss the attorneys' fees allegations in the complaint unless it appears certain that the Third-Party Plaintiffs could prove no set of facts in support of their claims which would entitle them to relief. *Moyo v. Gomez*, 40 F.3d 982, 984 (9th Cir. 1994); *Baker v. McNeil Island Corrections Center*, 859 F.2d 124, 127 (9th Cir. 1988). Finally, dismissal without leave to amend is improper unless it is clear that the complaint could not be saved by any amendment. *Daou*, 397 F.3d at 710; *Gompper*, 298 F.3d at 895.

Applying this strict standard, taking all the allegations of the Third Party Complaint (Docket No. 147) as true and construing them in the light most favorable to the Third-Party Plaintiffs, the Court finds that the prayer for attorneys' fees in the Third-Party Complaint are sufficient to survive dismissal. *Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1295-96 (9th Cir. 1998). Third-Party Plaintiffs' base their prayer for attorneys' fees on the premise of "as allowed

by law or the parties' contracts", which is more detail than Cossitt included in his claim for attorneys' fees and costs in Docket No. 162. More importantly, Cossitt failed to show that the Third-Party Plaintiffs' claims could not be saved by any amendment. *Daou*, 397 F.3d 710; *Gompper*, 298 F.3d 893, 895. Cossitt did not move for a more definite statement under Rule 12(e) but instead seeks dismissal of the Third-Party Plaintiffs' claim for attorneys' fees, and therefore he is bound to satisfy the strict standard under Rule 12(b)(6), which he failed to satisfy.

C. American Rule.

The American Rule denies attorney's fees in the absence of contract, applicable statute, or other exceptional circumstances, and any exceptions to the American Rule are narrowly circumscribed. *In re Acequia, Inc.*, 34 F.3d 800, 819 (9th Cir. 1994) (quoting *Richardson v. Alaska Airlines, Inc.*, 750 F.2d 763, 765 (9th Cir. 1984)). In addition to the American Rule, no general right to recover attorneys' fees exists under the Bankruptcy Code. *In re Montgomery*, 310 B.R. 169, 184 (Bankr. C.D. Cal. 2004); *Renfrow v. Draper*, 232 F.3d 688, 693 (9th Cir. 2000); *Ford v. Baroff (In re Baroff)*, 105 F.3d 439, 441 (9th Cir. 1997). *Heritage Ford v. Baroff*, 105 F.3d 439, 441 (9th Cir. 1997). Instead, whether attorneys' fees may be awarded in bankruptcy proceedings depends in part on whether the case involves state or federal claims and whether the applicable law allows such fees. "[A] prevailing party in a bankruptcy proceeding may be entitled to an award of attorney fees in accordance with applicable state law if state law governs the substantive issues raised in the proceedings." *Id.*; see also *Am. Express Travel Related Servs. Co. v. Hashemi*, 104 F.3d 1122, 1126-27 (9th Cir. 1996). For example, if a divorce decree provides for the payment of attorney's fees, and state law issues are litigated in the bankruptcy proceeding, attorney's fees are available, but only to the extent that they were

incurred litigating the state law issues. *Montgomery*, 310 B.R. at 184; *Renfrow*, 232 F.3d at 694. In addition, a bankruptcy court is prohibited from awarding attorney's fees for litigating federal law issues in bankruptcy court simply because state law may be "integral" to determining dischargeability. *Id.*; see *Baroff*, 105 F.3d at 442-43; *Hashemi*, 104 F.3d at 1126-27 (9th Cir.1996). In *Montgomery*, the court denied a request for attorney's fees to the prevailing party who did not submit any evidence at trial identifying the legal services rendered in the action solely with respect to the litigation of state law issues, the amount of fees incurred by reason of such legal services, nor the reasonableness of such fees. 310 B.R. at 184.

In the instant case Third-Party Plaintiffs' claim against Cossitt for attorneys' fees are related primarily state law claims. They seek consequential damages based upon Cossitt's alleged errors and omissions as a fiduciary and attorney, and under principals of equity under Montana law. The Montana Supreme Court stated Montana law in *Harding v. Savoy*, 2004 MT 280, ¶ 68-69, 323 Mont. 261, 277-78, ¶ 68-69, 100 P.3d 976, 986-87, ¶ 68-69 as follows:

The longstanding rule in Montana, also known as the American Rule, is absent a contractual or statutory provision to the contrary, attorney fees will not be awarded to the prevailing party in a lawsuit. *Pankratz Farms, Inc. v. Pankratz*, 2004 MT 180, ¶ 93, 322 Mont. 133, ¶ 93, 95 P.3d 671, ¶ 93 (citing *Erker v. Kester*, 1999 MT 231, ¶ 43, 296 Mont. 123, ¶ 43, 988 P.2d 1221, ¶ 43). In the present case, neither a statutory nor contractual basis for an award of attorney fees exists; however, in rare instances a district court may award attorney fees to an injured party under its equity powers. *Pankratz*, ¶ 93 (citing [*Foy v. Anderson* (1978), 176 Mont. 507, 511-12, 580 P.2d 114, 116-17.]

We have recognized equitable exceptions to the American Rule. See, e.g., *Mt. W. Farm Bureau Mut. Ins. Co. v. Hall*, 2001 MT 314, ¶ 14, 308 Mont. 29, ¶ 14, 38 P.3d 825, ¶ 14 (awarding attorney fees when a party incurs legal fees to establish a common fund which avails non-participating beneficiaries); *Montanans for the Responsible Use of the School Trust v. State ex rel. Bd. of Land Commr's*, 1999 MT 263, ¶ 67, 296 Mont. 402, ¶ 67, 989 P.2d 800, ¶ 67 (awarding attorney fees pursuant to the private attorney general theory). In addition, we have

awarded attorney fees when a party has been forced to defend against a wholly frivolous or malicious action. *Foy*, 176 Mont. at 511, 580 P.2d at 117. However, such awards are determined on a case-by-case basis. *Pankratz*, ¶ 93 (citing *Foy*, 176 Mont. at 511, 580 P.2d at 117). We have specifically declined to adopt a malicious or bad faith equitable exception to the American Rule. *Goodover v. Lindey's* (1992), 255 Mont. 430, 448, 843 P.2d 765, 776; *Erker*, ¶ 44. Further, we have held where a party chooses to institute a suit against others, an award of attorney fees to the plaintiff will normally be precluded. *Goodover*, 255 Mont. at 447, 843 P.2d at 775; *Youderian Constr. v. Hall* (1997), 285 Mont. 1, 15, 945 P.2d 909, 917.

See also, *Trustees of Indiana University v. Buxbaum*, 2003 MT 97, ¶ 19, 315 Mont. 210, 215-16, ¶ 19, 69 P.3d 663, 666-67, ¶ 19; see also, *Schuff v. A.T. Klemens & Son*, 2000 MT 357, ¶ 97, 303 Mont. 274, 305, ¶ 97 16 P.3d 1002, 1022, ¶ 97; *Hickingbotham v. Duncan* (1995), 271 Mont. 525, 531, 898 P.2d 1215, 1219; *Ehly v. Cady* (1984), 212 Mont. 82, 687 P.2d 687.

In *Schuff* the court quoted the United States Supreme Court holding that: "[T]he argument that attorneys' fees must be added to a plaintiff's recovery if the award is truly to make him whole is contrary to the generally applicable American Rule." *Schuff* ¶ 97, quoting *Norfolk & Western Ry. Co. v. Liepelt* (1980), 444 U.S. 490, 495, 100 S.Ct. 755, 758, 62 L.Ed.2d 689.

The *Foy* exception in Montana gives a court equitable power to award attorney's fees subject, however, to a caveat placed on the equitable power that the case must involve a "frivolous or malicious action". *Buxbaum*, ¶ 13. The court in *Erker v. Kester*, 1999 MT 231, ¶ 44, 296 Mont. 123, 135, ¶ 44, 988 P.2d 1221, 1228, ¶ 44, further distinguished *Foy* and its progeny by stating that "[t]he *Foy* exception has been narrowly drawn and is applicable only where the action into which the prevailing party has been forced is utterly without merit or frivolous," and "only in cases with particularly limited facts." (Quoting *Goodover v. Lindey's, Inc.* (1992), 255 Mont. 430, 446-47, 843 P.2d 765, 775-76).

Cossitt argues that no statutory basis exists for attorneys fees. However, his reply brief cites Montana statutes which provide for an award of attorneys' fees to prevailing parties, e.g., § 71-3-124(1) (allowing attorney fees to a defendant against whose property a lien is not established); and 37-61-407 (allowing award of attorney fees reasonably incurred against an attorney "who . . . multiplies the proceedings in any case unreasonably and vexatiously"). These statutes take the instant matter outside the American Rule by its definition, and under the strict standard for Rule 12(b)(6) dismissal, taking the allegations of the Third Party Complaint as true and construing them in the light most favorable to the Third-Party Plaintiffs, Cossitt's argument that the sections do not apply is unpersuasive at this stage of this adversary proceeding. *Daou*, 397 F.3d at 709-710; *Gompper*, 298 F.3d 893, 895.

Next, Cossitt argues that the *Foy* equitable exception to the American Rule cannot apply because this case does not involve a "frivolous or malicious action" and Cossitt did not sue himself, citing *Erker v. Kester*, 1999 MT 231, ¶ 45, 296 Mont. at 135, ¶ 45, 988 P.2d at 1228, ¶ 45. Again, however, Cossitt moves for dismissal rather than for a more definite statement, and failed to satisfy the strict standard under Rule 12(b)(6) that Rule of showing that Third-Party Plaintiffs could prove no set of facts in support of their claims which would entitle them to relief. *Moyo*, 40 F.3d at 984; *Baker*, 859 F.2d at 127. For Cossitt's failure to satisfy the strict standard under Rule 12(b)(6),

IT IS ORDERED a separate Order shall be entered in conformity with the above, denying Cossitt's Motion to Dismiss Claim for Attorneys' Fees for Failure to State a Claim Upon Which Relief Can Be Granted, filed January 25, 2005.

BY THE COURT

A handwritten signature in cursive script, reading "Ralph B. Kirscher", is written over a horizontal line.

HON. RALPH B. KIRSCHER

U.S. Bankruptcy Judge

United States Bankruptcy Court

District of Montana